

CALIFORNIA'S CONTINUING FISCAL CHALLENGE: AN OPPORTUNITY FOR CHANGE

California has a proud history of weathering crises and emerging stronger and more resilient than ever. This experience confirms that at the heart of every crisis is the opportunity for change.

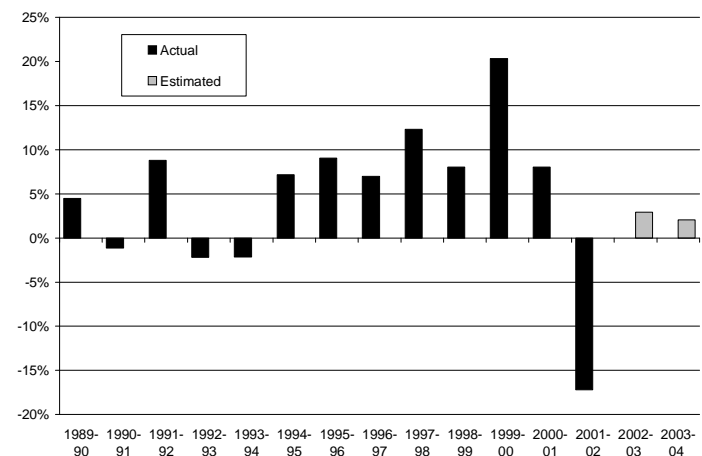
It is clear now that the U.S. and California economies are taking longer than expected to recover from the current downturn, and the stock market has lost a considerable amount of ground since mid-year. This has resulted in a significant downward revision in State revenues. General Fund revenues from the major tax sources are expected to fall to \$65.8 billion in 2003-04—far below the level of income the State expected to receive in the budget year as recently as the 2002-03 May Revision. This decline is by far the most dramatic loss of revenues California has experienced since World War II. This delay in the recovery of the national and state economies and a tax structure heavily reliant on volatile revenues have resulted in a budget shortfall in the current year and budget year totaling \$34.6 billion.

As California addresses this unprecedented fiscal crisis, we must seize the moment of opportunity that exists to make critical, necessary changes. But change should not be an end unto itself. Change must be part of a vision that continues to move California forward.

California can emerge from this crisis with stronger communities, more efficient government, and a new blueprint for meeting the challenges ahead. But we will succeed only if we are willing to set aside partisanship and put California's future first.

FIGURE A

**Major General Fund Revenue Growth
1989-90 to 2003-04**



Resolving the Immediate Fiscal Crisis—The 2003-04 Budget closes the \$34.6 billion budget gap and reflects five key elements:

- ◆ It is balanced, whereby expenditures match available revenues.
- ◆ It includes difficult, but balanced decisions including: cuts/savings (59.9%), State-local program realignment (23.6%) with dedicated revenue sources, fund shifts (5.5%), transfers/other revenue (6.1%), and loans/borrowing (4.9%).
- ◆ It includes revenue increases only for local government. There are no tax increases for State government in this Budget.
- ◆ It contains a \$531 million reserve.
- ◆ It substantially eliminates the anticipated \$12 billion structural shortfall between revenues and expenditures in 2003-04.

Ensuring California's Long-Term Fiscal Integrity—This Budget reflects a balanced spending plan for 2003-04, and calls for the development of a new fiscal blueprint for California's future:

- ◆ It calls Californians to action to reform both our existing revenue and expenditure policies to enable the State to provide for the needs of its citizens in the future, especially during periods of economic downturns.
- ◆ It seeks structural reform in State and local governance and finance to achieve more rational and responsive service delivery systems.
- ◆ It proposes restoration of Executive Branch authority to make mid-year adjustments to the Budget when revenues fall significantly below budgeted forecasts.
- ◆ It urges the creation of a special budget reserve for proceeds from extraordinary revenue growth to be used for one-time expenditures.

Primary Features of the 2003-04 Governor's Budget

A Balanced Approach—Closing a \$34.6 billion budget gap requires a balanced solution and consideration of every available option. In addressing the current shortfall, some might urge closing it predominantly with one-time versus ongoing solutions. This approach cannot work this year since most of the one-time approaches have been exhausted. Moreover, with the economy rebounding much more slowly than predicted by forecasters last year, additional reliance primarily on one-time fixes would only exacerbate the underlying structural imbalance we face going forward.



Others will suggest that our budget problem must be solved solely with program reductions—regardless of the cost or consequence. Cuts will, of course, be part of any solution, but a shortfall of this magnitude cannot be solved with reductions alone without seriously damaging the education of our children, our ability to protect public health and safety, our commitment to provide health care for our children, and protection of our environment.

Still others would advocate closing the budget gap completely with tax increases. This would not be responsible and could further delay California's economic recovery. Furthermore, even if every tax increase considered by the Legislature last year were adopted, the additional revenue generated would not even close 50 percent of the shortfall.

This Budget contains difficult and controversial elements. However, it rejects rigid ideology and reliance on unrealistic solutions. Instead, this Budget presents a balanced combination of steps needed to meet this enormous challenge. The 2003-04 Budget includes the following:

- ◆ **Substantial reductions in spending**—Even with the other solutions contained in this Budget, these reductions are necessary to help eliminate the structural imbalance between revenues and expenditures going forward.
- ◆ **Increases in revenues for local governments**—All of the proposed tax increases in this Budget are dedicated to local governments to preserve key programs pursuant to the State-Local Program Realignment. This realignment is intended to provide greater local program responsibility as well as greater flexibility in program administration and service delivery.
- ◆ **Less reliance on loans and borrowing**—This Budget relies less on loans and borrowing than in previous years to address budget shortfalls.
- ◆ **Spreading reductions to programs across all areas of State government**—Virtually all programs contribute to the solution.

Key Priorities Protected—With a shortfall of this magnitude, no area of the Budget can be held harmless. However, the Budget minimizes the impact of reductions to the greatest degree possible in several key program areas:

- ◆ **K-12 Education**—Education remains this Administration's first priority. However, given the magnitude of the budget shortfall, the Budget does make reductions to K-12 education, accounting for 23.9 percent of all solutions to close the budget gap—significantly less than its proportionate share of General Fund spending (40.1 percent).



- ◆ **Health Coverage for Children**—This Budget protects funding to ensure every eligible child gets health coverage under the Healthy Families and Medi-Cal for Children programs and continues to expand efforts that streamline the enrollment process.
- ◆ **Public Safety**—This Budget protects key public safety programs, including enhanced security measures enacted after September 11, 2001, the Citizens' Option for Public Safety, Juvenile Crime Prevention, Technology Funding for Local Law Enforcement, and the Rural and Small County Law Enforcement Assistance programs.
- ◆ **Environmental Protection**—Voter approval of several resources bond measures in recent years allows for continued funding of critical environmental programs, while reducing General Fund costs in 2003-04. This Budget expands the principle of "polluter pays" by shifting the source of funding for several enforcement and regulatory programs to fees paid by the regulated industries. Programs affected include the California Air Resources Board's Stationary Source Pollution Program and the State Water Resources Control Board's core regulatory programs.

Clear Policy Choices—Following several successive rounds of unallocated reductions or "across-the-board" cuts, State agencies and departments have implemented significant reductions to programs and services. Further unspecified reductions of this nature will only serve to reduce the effectiveness of remaining programs and services. Therefore, this Budget targets most reductions to specific programs, and in some cases, eliminates programs altogether where reduced levels of funding will render those programs ineffective.

All Tax Increases Go to Local Governments—Consistent with the Administration's goal to reduce the size of State government, this Budget contains no general tax increases for State government. Rather, this Budget increases taxes to preserve critical programs, including those serving our senior citizens and children and youth, that are proposed to be realigned to local governments. These programs would be subject to significant reductions if they continued to be supported by the State General Fund.

Structural Reform—This Budget calls for action on key reform proposals to develop a new fiscal blueprint for California. These reform measures, among other things, must address an outdated revenue structure, an over-reliance on volatile revenue sources, and changes to statutory spending policies.



**Addressing A \$34.6 Billion Budget Gap:
Administration Takes Early Action**

- ◆ Governor submits 2002 Mid-Year Spending Reduction Proposals totaling \$10.2 billion to the Legislature in December 2002.
- ◆ Governor calls the Legislature into Extraordinary Session beginning December 9, 2002, to facilitate prompt action on these proposals.
- ◆ The Administration directs State departments to freeze current-year spending, identify General Fund savings, and reduce expenditures.
- ◆ Since the beginning of this Administration's first term, more than 12,600 vacant State positions have been eliminated.



